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經營學碩士 學位論文

A Study on Establishing FTA for solving the trade deficit  
problems between China and South Korea

한·중간 무역적자 해소를 위한 FTA 체결에 관한  
연구

指導教授 李 秀 昊

2008 年 8 月

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# **Abstract**

## **A Study on Establishing FTA for solving the trade deficit problems between China and South Korea**

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Since August 24<sup>th</sup> 1992, China had an official establishment of diplomatic relationship with South Korea, there are many cooperation between two countries, such as culture, natural resources, human resources and industrial structure. And especially in the economic cooperation, China and South Korea have become important trade partners.

For mutual benefits, amiable and cooperative relationships have been built up between technological, cultural, educational, and legislation departments in both countries and local governments.

However, as the bilateral trade goes forward with a rapid pace, the conflict caused by imbalance of bilateral trade has been intensified and trade friction and disputes occurred from time to time, which has undermined the healthy development of bilateral ties.

In my paper, I analyzed on these problems and pay attention to the increased trade deficit of China. After consulting previous literature research, I infer the reasons for increased trade deficit of China. I also suggest strategies for solving the problem of trade deficit, which is to establish the FTA between China and South Korea.



# 國文抄錄

## 한중간 무역적자문제 해결을 위한 FTA 체결에 대한 연구

무역학과

Xu Jing

지도교수 이 수 호

1992년 8월 24일 한중간 공식적인 외교수립 이후 양국은 문화, 자연자원, 인적자원과 산업간 다방면에서 활발한 협력이 이루어지고 있다. 특히 경제협력분야에서 양국은 서로 중요한 파트너가 되었다. 즉 우호적이고 협력적인 관계가 기술분야, 문화분야, 교육분야 그리고 입법분야 등에서 이루어져 양국에 상호이익을 가져다 주었다.

그러나 한편에서는 양국간 무역의 규모가 빠른 속도로 확대됨에 따라 무역불균등이 심화되고(중국의 대한민국 무역적자, 한국의 대중국 무역흑자) 이에 따라 무역분쟁이 발생하는 횟수가 증가하고 있다. 이러한 무역분쟁은 양국간 앞으로의 우호관계 뿐만 아니라 경제발전에도 도움이 되지 않을 것이다.

본 논문은 이러한 배경하에서 한중간 무역불균형 현황에 대해서 살펴보고 왜 이러한 무역불균형이 발생하고 이것을 해결하는 방법이 무엇인지를 모색하고자 하였다. 이러한 무역불균형은 상대적으로 기술집약적인 재화, 즉 부가가치가 높은 재화를 중국은 한국에서 수입하고 상대적으로 노동집약적인 재화, 즉 부가가치가 낮은 재화와 농산물을 한국에 수출하는 것으로 산업간 또는 산업 내에서 상호보완적인 산업관계에서 기인하는 것으로 분석되었다.

이러한 상호보완적인 산업구조에서 발생한 여러 가지 무역분쟁을 해결하는 방법으로 한중간 자유무역협정(FTA)을 체결하는 방법은 이 논문에서 제시한다. 이것은 한중간 산업구조와 무역구조를 비교우위에 바탕을 두고 제조정하여 국제분업을 달성하여 장기적으로 양국간 무역불균형문제를 해결할 수 있을 것으로 기대된다.

# Chapter 1

## Introduction

### 1-1 Background

China and South Korea have associated with each other for a long time in history. The two neighboring countries not only resemble each other in traditional culture, but also are complementary in other aspects, such as natural resources, human resources and industrial structure.

Since the official establishment of diplomatic relations between the two countries on August 24<sup>th</sup>, 1992, they have endeavored to improve their ties rapidly in various fields. In terms of economic cooperation, China and South Korea have become each other's more and more important partners in trade. Politically, they have deepened their mutual understanding and trust through frequent exchanges of visits of top governmental officials and multilateral meetings on international events. Bilateral ties have also resulted in fruitful achievements in the fields of culture, education, technology and so on. They have also expanded their cooperation and improved coordination in regional and international affairs.

Since the establishment of diplomatic relations, various kinds of trade agreements and investment protective treaties have been signed between the two countries, so that the bilateral trade cooperation has been put on the track of steady, healthy and rapid advancement. Although starting late, bilateral economic cooperation has advanced so rapidly that they have tapped their potential for economic development. Recently, to South Korea, China has become the largest export and

investment destination country, second largest trade partner, and the third largest import source country in the world.

On July 8<sup>th</sup>, 2003, Wen Jiabao Chinese premier, when meeting Roh Moo-hyun, president of South Korea, stated that we would like to further consolidate and expand our trade relations with South Korea and boost mutual and common prosperity of two countries based on the today' sound bilateral relations under the guideline of "equality , mutual benefit, and complementing each other's advantages". He also noted that China and South Korea will enjoy the benefits from the advantages of complementary relation in economic area, Potential cooperation and promising prospect. So China will attach great importance to the trade ties between two countries. Korean President Roh Moo-hyun said that South Korea and China are actively involved in various mutual economic activities related with trade and investment. South Korean government will further promote exchanges and cooperation on the basis of mutual benefits, and work, jointly with Chinese government, for common development and prosperity of Northeast Asia.

Amiable cooperative relations have been built up in the fields of technology, culture, education and legislation at the level of central and local government of the two countries. China has set up Consulate General in Seoul and Pusan, and South Korea has also established Consulate General in Shanghai, Qingdao, Guangzhou, and Hong Kong. Meanwhile a Consulate General office is also set up in Shenyang. By the end of 2007, 69 cites from both countries have established Sister City Relationship. Direct flights are available between South Korean cities Seoul and Pusan, and Chinese cities of Beijing, Qingdao, Chengdu, Nanjing, Xi'an. Passenger and cargo ships travel between China cities of Shanghai, Shenyang, Tianjin, Qingdao, Dalian,

Yantai, Weihai, and Korean cities of Inchon and Pusan on a regular basis. Thanks to convenient transportations, people from both sides are undergoing frequent exchanges.

In 2002, the amount of South Korean visitors to China reached 2.12 million, while Chinese tourists to South Korea also amounted to 550,000. By the end of 2002, the number of South Korean overseas students in China reached 22,000.

However, as bilateral trade goes forward at a rapid pace, conflicts caused by imbalance of bilateral trade occurred and trade friction and disputes were reported from time to time, which hindered the healthy development of bilateral ties. Thus, it is urgent for governments of two countries to deal with such thorny issues as reorientation trade relations of China and South Korea, directions of future cooperation and solution to recent friction and disputes.

So, in this thesis, I'd like to characterize the conflicts between two countries in the light of economic view. And it will be suggested what policies will contribute to extenuate them.

## 1-2 Research Methodology

Review literature method: Through reviews of the previous research related to this thesis, I summarize the crucial point and extract the insight and consistency. And then summed up the pros and cons of this field study

Contradistinctive and analytical method: Expatiating on the reality of Chinese and South Korean trade and feasibility analysis on China and South Korea FTA, at the same time I analyzed a lot of data about trade between China and South Korea. From the comparison I get my own conclusions.

Quantitative analysis method: My research bases upon a large number of trade data.

### 1-3 Structure of the study

In my thesis I mentioned about the problems of Chinese and South Korean Trade, and points out trade deficit is the most serious problem.

First, analyze the present situation and] problems between two countries, and points out trade deficit is the most serious problem,

Second, refer to the consulting previous literature research, and study the trade relativity, and find nowadays the trade deficit is the argumentative emphasis.

Third, I through the industry structure analysis of China and Korea and Complementary resources between China and Korea to analyze the trade deficit.

Last, I suggest to establishing China and South Korea FTA to solve problems.

## Chapter 2

# Present Situation and Problems of The Trade between China and South Korea

### 2-1 Present Situation

#### 2-1-1 General Situation of Chinese and South Korean Trade in Recent Years

Before 1992 when China officially set up diplomatic relationship with South Korea, there were seldom direct trade ties between the two countries. Trade was conducted through a third country or region (Japan or Hong Kong). Since 1992, the two countries have set up direct trade relations, and bilateral trade has developed in leaps and bound with the normalization of bilateral relations. In 1991, Chinese and South Korean trade volume was only 3.25 billion USD, while in 1993 it was doubled to 8.22 billion USD. In 2007, total bilateral trade volume reached 63.23 billion USD, 20 times of the volume in 1991. Meanwhile, Chinese and South Korean trade volume has surpassed that of trade between the Chinese mainland and Taiwan, and South Korea has become the sixth largest trade partner of China. During this period of time, foreign trade of China has expanded 5.14 times in size, with an annual growth rate of 16.1%, while the size of South Korean trade went up 2.35 times with an annual growth rate of 8.1%. From these statistics figures, we can see that the growth of bilateral trade has outweighed the general trade increase of both countries<sup>1</sup>. With the fast development of Chinese and South Korean trade, two countries will (would?) become important trade partners. However as we can see from table 2-1, since 2002, China has been undergoing trade deficit towards South Korea. In the year 2003, China

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<sup>1</sup> MA Xiaohui, "The Analysis of the Development and the imbalance problem of Chinese and South Korean Trade," Northern Economy and Trade, 1, 2008, pp.34-38.

surpassed USA and became the largest export destination country of South Korea, accounting for 18.1% of the total export volume of Korea, and also the third largest import country of South Korea, accounting for 12.3% of the import volume.<sup>2</sup>

Table 2 – 1: Chinese and South Korean trade since the 2001(Unit: 100million USD)

year	Total trade volume	Export to Korea	Import from Korea	Balance
2001	32.5	21.8	10.7	11.1
2002	82.2	28.6	53.6	– 25.0
2003	169.8	66.9	102.9	– 36.0
2004	240.5	91.2	149.3	– 58.1
2005	250.4	78.1	172.3	– 94.2
2006	359. 1	125. 2	233. 9	– 108.7
2007	632.3	201.1	431.3	– 230.3

Source: Statistics from China Customs Year Book (2001—2007)

According to the statistics from China Customs, in 2005, Chinese-South Korean bilateral trade volume reached 100 billion USD, Sino-European and Sino-American trade volume reached 200 billion USD. By the year 2005, the trade scale of China and its six largest trade partners had all surpassed 100 billion USD.

EU has remained as the largest trade partner of China, with bilateral trade volume of 217.31 billion USD, increasing 22.6%. USA ranks the second, with total volume of 211.63 billion USD, increasing 24.8%. Meanwhile, Japan is the third largest trade partner and the bilateral trade volume has reached 184.45 billion USD, increasing 9.9%. In 2005, the import growth of China from Korea and ASEN

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<sup>2</sup> Piao Shen-min, “On Trade Return Analysis and Economic Return Prediction of the Sino-Japan-South Korea Free Trade Zone,” Journal of Shijiazhuang of University of Economics, 4, 2004, pp.54-58.

surpassed the overall increase rate, with Chinese and South Korean trade volume reaching 100 billion USD, including import from Korean of 768.2 billion USD, increasing 23.4%, 5.8% more than overall import growth. Korea has become the second largest import source destination of China, jumping from No 5 to No 2.

These facts shows that China and South Korea is getting closer and closer in economic aspect

## 2-1-2 Reasons for Large Scale Increase of Chinese and South Korean Trade

(1) The two countries has enjoyed rapid economic growth since the new century, with China's annual growth rate of 9.7% and Korea 4.6%, which provides not only rich material sources but also large potential market.

(2) With the increase in exchanges and visits of top government officials, the bilateral relations are blessed with steady development and South Korea has fully acknowledged the market economy status of China, which offers good political environment for trade development.

(3) South Korean products are technologically advanced and considerate in after sales services, thus enjoying competitive edge.

(4) After Chinese entry into WTO, china has a more open market and internationally compatible trade policy, regulation and legislation, which means China has improved its trade environment to a large extent and strengthen our import capacity.

(5) In recent years, FDI from South Korea to China has soared, which encourages the export of parts and products from South Korea. Meanwhile, products manufactured in China will be sold back to South Korean market, which has actually



increased the export volume of China towards South Korea. According to the statistics of China Customs, in the latest six years, import from China to South Korea increased 26.6%. According to statistics of South Korea, in 2004, China surpassed America, becoming the largest export market of South Korea.

## 2-2 The Problems

At present, though the volume of bilateral trade has undergone rapid increase, many problems remain present themselves.

### 2-2-1 Increased Trade Deficit of China

Since 1993, China has experienced considerable trade deficit from South Korea every year, especially in recent years, the value of deficit has become more and more prominent. From 2001-2005, China's deficit towards South Korea has increased every year. Now China has become the second largest country next to USA in GDP level which provides a large market to South Korea. So that South Korea enjoys favorable trade balance. The deficit mainly resulted from the following reasons: first of all, labor intensive products have been produced in China and distributed worldwide, by making use of low cost of China, importing key parts and technology from South Korea and Japan, and selling the final products to Europe and USA. Second, import from China has increased substantially and outweigh export. For example, in 2006, the volume of export to South Korea increased 26.8%, but it still could not catch up on the growth rate of export with the import with a further increase of 16.9%. Third, the inadequate exploration towards South Korean market leads to the lack of products fitting in with South Korean market<sup>3</sup>. Fourth, South Korean enterprises highlight

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<sup>3</sup> Zhang Yuhe, "Sino- South Korea Trade Pattern Alternation: From Mutual Complement to Competition," *International Economics and Trade Research*, 1, 2006, pp.39-43.

export to China but are not very willing to import from China for the reasons of tariff or other restrictions, which makes China it difficult to enter into South Korean market.

### 2-2-2 Low Level of Localization of South Korean Companies in China

South Korean companies in China seldom employ Chinese in the management level, and the common employees are also mainly South Korean, even the drinking water of the employees is transported from South Korea. Unlike South Korea, other developed countries such as America and Japan pay much attention to the localization of their trade companies in China. They employ local people both as common workers and also as general manager, with a high sense of localization. The reason may lie in the difference of company culture; for some South Korean people think they have learned enough corporation knowledge and a high ability of management, which make themselves unwilling to listening to others' suggestions, thus giving other people a feeling of arrogant or even treating Chinese employees with indignity. On the contrary, the managers and employees of America's and Japan's companies in China pay much attention on the etiquette and working method, listening to others' suggestions, building a relatively harmonious relationship among leadership and employees, which make a good working atmosphere. Even there are some disputes between management personnel and common employees, it is easy to deal with and easy to rebuilt the relationship.

### 2-2-3 Limited Information on Counterparts

After the intercourse for over 20 years, and through the publicity of various ways, China and South Korean have known each other much better. However, because of some limitation of condition and some factors, subject or object, some trading corporations of both sides have not got enough necessary information, which could make some companies carry out their economic plans according to the limited materials and knowledge. As a result, there appears a large gap between the actual situation and the information they got and their prediction, and also the following make-up measures are untimely, resulting in the suspension of the cooperation and the economic loss<sup>4</sup>. As for further reasons, some trade companies of South Korea in China have not done adequate research on China's market. As a result, some small or medium trading companies have many cooperation programs with China, but only a few of them can be finally carried out. The reason is that the preparation work of both sides is insufficient and unsteady, i.e. the information in hand is not comprehensive, which causes the waste of human and financial resources as well as time.

Nowadays more and more Chinese and Korean scholars are focusing on the trade disputes, the trade deficit in particular.

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<sup>4</sup> Li Jingyu & Shang Lihui, "Analysis of the strategic upgrading economic & Trade Cooperation between China and South Korea," *International Forum*, 3, 2004, pp43-44.

## Chapter 3

### Literature Review

Present literature has fallen into several categories: trade relativity, trade disputes, anti-dumping study, and trade dispute of Korea or China with other nations, as well as perspectives of trade disputes. In this paper I attached great weight to the studies on Chinese and South Korea trade disputes, including different views hold by scholars from the two countries and analytical strategy employed in trade dispute analysis. Finally, a summary of studies on trade disputes of Korea and China with other countries will serve as a forceful support of the finding of present research finding.

#### 3-1 Review on Trade Relativity

Both Chinese and Korean scholars have studied the comparative advantages of industry in two countries. Chinese scholar Li Hongfei (2004) analyzed the influence of similar product range exported to ASEAN (Association of Southeast Asian Nations) from China, Korea and Japan. His South Korean counterparts Sin Hyun-su and lee Won-bok (2003) discussed competitive strength of manufacturing industry in the three nations and proposed policy implication. Oh Dong-hyun (2003), also a South Korean, studied competitive strength of Korea and Japan in the Chinese market. All of the studies mentioned above came to a similar conclusion through RCA (Revealed Comparative Advantage Index) index analysis that competition exists among China, Korea and Japan concerning the product range exported to ASEAN, especially for mechanical and electronic products. There is no substantial difference concerning product quality among these three countries and all of them cover large accounts of export volume to ASEAN. However, each of them has its own features and specialties. Thus the trade relationship between ASEAN and three nations is better pictured as

coexistence instead of "Waxing and Waning". Japan still enjoy the advantage of high-end product , followed by Korea, while China still positions in the low end, which causes the concern of many scholars on the issue of intense competition resulted from similar product range between China and Korea. As for the solution, Chinese and Korean scholars hold different opinions. Most Chinese scholars contend to solve this issue through product differentiation, while voices from the Korean sides prefer cooperation through economic regionalization.

Bang Hok-tying (2004) from South Korea conducted a study on one quarter of the areas of the three nations, reporting trade contribution of China and South Korea. Park Byun-shun (2004) explored China's uprising and northern Asia economic cooperation strategy. Choi Yung-shup (2001) analyzed future competition of manufacturing industry through trade specialization index. Hyundai Economic Institute has revealed the fact that intense dependence of Chinese and South Korean trade ties will result in severer trade disputes. Due to the fact that under the vertical industry division structure, economic cooperation will be hindered, they suggest that economic regionalization will be an alternative way out. Development Research Center of the Chinese State Council hold the opinion that industrial division between China and Japan is more mature than that of China and Korea. Industrial division of the China and Korea is only confined to high-tech industry, thus they think that there will be a large space for the improvement of industrial division.

Some studies tend to explore trade competition and complementariness between China and Korea. Zhao Jinping (2002) studies Sino-Japanese and Sino-South Korean trade growth and trade structure. Wang Shouyang (2003) did a comparative study on export commodity structure, reaching the conclusion through trade concentration

analysis that two countries enjoy high trade concentration and bilateral trade development is on the track. On the contrary, Jin Yingui (2004), Zhangyuhe (2005) and Yin Zhichun (2006) argued that complementariness between China and Korea has been undermined, and competition will definitely rise from rapid economic growth, hence coordination is necessary. Jeong Ong-in (2000), Yoo Jin-sheng (2001) and Bang Ho-kyung (2002) figured out that fierce competition and emerging of trade disputes will result from ever increasing high concentration of trade with further trade contact, because both countries have high trade concentration, high complementariness and high level of competition as well. They believe readjustment of product range will be a good choice. KOTRA (2003) came to the conclusion that the level of competition of Japan-Korean trade is much higher than that of China and South Korea. However, in recent Korean market, Chinese product covers a larger and larger market share, and vice versa.

They contended that two countries should jointly work out a possible solution to the issue in increase of disputes resulted from competition for a larger market share. Lee Hong-bae from Korea and Okamoto Nobutaka from Japan published their research findings on the study of interdependence of Korea, China and Japan that China depends much on Korea in terms of intermediate product. After analyzing different industries, they pointed out that in certain industries those three countries have high dependence level, which will stimulate the expansion of production scale in China and Korea. While China is more independent than Korea, which indicates that China has a more stable industrial structure.

### 3-2 Review on Trade Disputes

Many researches are focusing on problems in China-South Korea trade. Peng Wenbing (2003) discovered that China and South Korea resembles each other in economic development structure featured as high dependency on international trade. Thus it is necessary for both countries to readjust industrial structure. Li Guizeng (2003) regarded fierce competition as the most prominent issue, which is the main reason for the occurrence of trade disputes. Su Kewu (2004), Wang Suqin (2003), Fan Aijun and Jin Ning (2000), Wang Lengyi (2003), Du Yonghao (2002) on the contrary held the opinion that both bilateral trade dependence and complementariness are in good condition, while the problem that remained unsettled is the long term trade deficit resulting in trade disputes between China and Korea. Gao Yuan (2004) proposed reduction in bilateral trade deficit and improvement of bilateral free trade.

South Korean Economic Policy Research Institute (2003), Lee Jang-kyu (2002) and South Korea Rural Economic Research Institute showed their concern about over-fierce competition and intensified trade disputes. They held different views towards trade deficit that high dependence of intermediate products of China on Korea and Japan is only periodic phenomenon, which will not last long. Due to trade deficit and market competition, anti-dumping and disputes will increase, which is in need of coordination of both the governments. A report on trade published in Korea (2005), Korean Long-term Trade Forecast, predicted that by the year 2008, bilateral trade will enjoy balance of payment. Moreover, according to the present trade scale, technology and pace of development of China, around 2010, China will enjoy favorable balance.

### 3-3 Review on Antidumping Disputes

Macro anti-dumping studies are abundant, while specific empirical analysis is rarely seen. Europe and America are the countries that frequently adopt anti-dumping procedure, thus most of the researches on this topic are conducted by them. They normally work out an applicable industry environment prototype to analyze the influences of anti-dumping. Kim Suk-min (2004) proved in his research that anti-dumping litigation from Chinese side does not fulfill its purpose of restricting import from Korea.

A dissertation from Zhejiang University figured out the major issues concerning China-South Korean trade disputes are as follows: trade relevance, business disputes, and anti-dumping are all because of the differences of anti-dumping legislation of the two countries. Thus a thorough understanding of the difference will be an effective way to avoid disputes.

In other studies on anti-dumping cases, researchers from Hyundai Economic Research Institute tend to regard dumping as company strategy from the perspective of export country. W. J. Ethier (1982) interpreted that dumping is a company strategy in the same industry under the circumstance of uncertain surroundings and incomplete competition. Dumping is an alternative way to adjust unemployment in the relevant industries between two countries under the condition of uncertainty of demand and market for factors of production. He also analyzed below-cost dumping issue. As a result dumping does not necessarily mean unfairness.

R. M. Bierwagen (1990), holds that price discrimination, as a marketing strategy, can create comparative advantage in market. Thus it does not equal to unfairness. Though low-price dumping will lead to sales reduction in domestic market, high unemployment rate, harm to operation, which is of same negative effects on



non-dumping low price products, it is beneficial to consumers and intermediate manufacturers. This idea of price differentiation has now been well received in the circle of economics and law. L.Deleon(1997)contended that export products at the price below home country is a positive competitive strategy.

M. KoSteCki (1991) classified anti-dumping motivation into eight categories and viewed that each kind of dumping can be justified except predatory dumping. It is not advisable to regard dumping as totally unfair and unjustified competition, which has exerted an influence on the international anti-dumping legislation.

Jacobin (1923) categorized dumping into Sporadic dumping, intermittent dumping and long-term dumping in terms of time span of dumping. Sporadic dumping refers to dumping products overseas to prevent from inventory in a short period of time, which, in his opinion, is of no great significance, because it will exert no severe damage to industry of import country. Viner assumed that only predatory dumping will be imposed on anti-dumping legislation, because it will damage industry of import countries. However he also mentioned that the damage to the industry is once and for all, being impaired or changing the product line, the benefit for the consumers will be long-term and accumulative. Thus it should not be boycotted. J. F. Beseler & A. N. Winiam (1986) classified dumping into four kinds according to its purposes: Closeout of inventory and redundant product, maximization of short-term profit above marginal cost but below average cost, maintain market share and employment rate, predatory and monopoly, among which the first three of non monopolized purpose are pricing strategy by different firms are not the major concern of anti-dumping litigation, but the last one is.

## Chapter 4

### Analysis of Trade Deficit between China and South Korea

#### 4-1 Industrial Structure of China and South Korea

##### 4-1-1 Indicators of Industrial Structure

There are mainly two indicators to measure the industrial structure: the first one is value indicator, such as the proportion of the total output value made by an industry department among GDP; the other one is employment indicator, such as the proportion of the employment number of an industry among the total employment number. In this paper, the analysis of both China's and Korea's industrial structure is based on the three major industries classification. The first industry refers to agriculture (including forestry, grassland farming and fishing industry, etc.); the second industry refers to Industry (including mining, manufacturing, water supply, electricity, vapor, hot water and coal gas) and construction Industry; the third industry refers to the industries besides the first and second industry above, with mainly two parts: circulation sector (including transportation, catering business, material supply, telecommunications, and storage) and service sector (including sectors served for production and daily life such as banking, insurance, tourism; sectors served for improving the literacy and quality of the people such as education, culture, scientific research and health care; and also sectors served for the social needs such as government offices, social organizations, armies and police system).<sup>5</sup>;

##### 4-1-2 The Result and Its Interpretation

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<sup>5</sup> Zhou Xuechun , "Speeding Up the Construction of Sino-Korean Free Trade Area to Promote the East Asian Economic Integration," *All-round Southeast Asia*, 6, 2005, pp.37-39.

Generally speaking, the industry structure of China and South Korea is complementary, as we can see from table 4-1 and table 4-2. In recent years, the first industry takes a very important position in China's economy, and it contributes over 50% of China's GDP, while the leading industry of Korea is the third industry, which makes 55% contribution to its GDP.<sup>6</sup> China's labor resources are mainly gathered in the first industry, while the employees of Korea mainly focus on the third industry, which again proves that the complementary industry structure of the two countries. China and South Korea is developing at different levels; China is a developing country making efforts on the industrialization, while Korea is a new industrialized country, thus the two countries can complement and transmit each other's advantages greatly on industry and technology.<sup>7</sup>

Table 4 – 1 : GDP composition of China and South Korea

Year	GDP	The first industry		The second industry		The third industry	
		China	Korea	China	Korea	China	Korea
2004	100	18	5	50	43	32	53
2005	100	16	5	51	42	33	53
2006	100	16	4	51	42	33	53
2007	100	15	4	51	40	44	56

<sup>6</sup> Qin Yiqun & Jin Zhe-song, "A Positivist Analysis of Intra-Industry Trade Between China and Korea," Journal of Central University of Finance & Economics, 3, 2005, pp.19-22.

<sup>7</sup> Chen Rui & Huang Guanyue, "An Empirical Study of the Impact of Some Macroeconomic Factors on China's Export to Korea," Journal of International Trade, 4, 2007, pp.28-30.

Table 4 – 2 Employment composition of three major industries unit : %

year	Numbers of employees	The first industry		The second industry		The third industry	
		China	Korea	China	Korea	China	Korea
2004	100	48	11	20	31	32	58
2005	100	48	12	18	28	34	60
2006	100	47	12	18	27	35	61
2007	100	46	11	17	28	36	61

Data source : UNSD—National Accounts Main Aggregates Database; and data source : web site of China’s State Statistics Bureau [http : //www.stats.gov.cn](http://www.stats.gov.cn)

## 4-2 The Analysis of Comparative Advantage

### 4-2-1 Indicator of Comparative Advantage (RCA)

In 1960s and 1970s, American economist BalaSSa developed Comparative Advantage Model, which made Comparative Advantage theory developed from theory study to experimental research, thus made the theory with more practical significance. Revealed Comparative Advantage method was adopted by BalaSSa in 1965 when measuring some national trade comparative advantage and was commonly used by the World Bank Organization thereafter. The characteristic of RCA is that it does not analyze and compare the determined factors directly, but to measure the comparative advantages indirectly through the results of the import and export of the products. The reason is that the import and export results of every country is because of the existence of the comparative advantages of each country, thus the comparative

advantages of each country can be revealed through the analysis of the products import and export results<sup>8</sup>.

The RCA index refers to the ratio of a nation's relative export share of a certain industry or product in the world with its relative export share of all the export products in the world. The formula is as follows:

$$RCA_{ij} = (X_{ij}/X_j) / (X_i/X_r)$$

i refers to the nation; j refers to the industry;  $RCA_{ij}$  refers to the revealed comparative advantages of j industry in nation i;  $X_{ij}$  refers to the export amount of industry j in nation i;  $X_j$  refers to the export amount of industry j all over the world;  $X_i$  refers to the export amount of all the products in nation i,  $X_r$  refers to the export amount of all the products in the world. Generally speaking, if the index is more than 1, the industry of this nation has comparative advantages; if it is less than 1, then there is no comparative advantage. If there is a great difference among the RCA index of a certain industry of all the member nations, then there is a revealed complementation in this industry, otherwise, if the RCA indexes are very close, the industrial competence ability will also be similar. In the practice, we have classified the trade products into ten major types according to the unidigit index of UN Standard International Trade Classification: (0) Food and Live Animals Used Chiefly for Food; (1) Beverages and Tobacco; (2) Non-Edible Raw Materials, (3) Mineral Fuels, Lubricants and Related Materials, peltry, raw kolinsky skin, oil-bearing seed, natural or synthetic rubber, wood, paper pulp, textile fiber, natural fertilizer, metallic mineral ore; (4) Animal and Vegetable Oils, Fats and Wax; (5) Chemicals and Related Products; (6) Light and Textile industrial Products, Minerals Metallurgical Products;

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<sup>8</sup> Li Dun, "Empirical Analysis on the Intra-industry Trade between China and South Korea," *Journal of International Trade*, 4, 2007, pp.48-51.

(7) machines and transportation equipments; (8) health and water transportation as well as heat supply and light equipments, furniture, travel materials, shoes, watches, etc. (9) Miscellaneous Products

Among these ten types, 9 types from 0 to 8 can be further classified into three major types: primary products in type 0 to type 4 can be considered as natural intensive products; finished products in type 6 and type 8 can be considered as labor intensive products; finished products in type 5 and type 7 can be considered as capital and technology intensive products. If the exports of products with comparative advantage in a nation mainly focus on one type of these three, we can induce the basic condition of the nation's resource structure according to the logic of O model. However, this classification is relatively general and not very specific. Even if there is complementary relation in a certain product (such as capital intensive products), there are still some differences in the advantages if we further analyze. As a result, in order to improve the accuracy, we need further classification and further prove the result according to the overall analysis, to correspond to the practice.

#### 4-2-2 The Result and Its Interpretation

Table 4-3 and Table 4-4 shows the comparative advantage of two countries, from which we can see China's advantage is lying upon labor intensive industry, while Korea is on industrial products, especially capital or technology intensive products. China enjoys advantage in textile industry because of cheap labor resources and Korea enjoys advantages in mechanics and transportation equipment due to abundant capital and advanced technology. Thus generally speaking, China and South Korea are complementary in trade.

First of all, two countries are complementary in natural resources. China is rich in agricultural and mineral resources while Korea is short of natural resources, energy and industrial materials. Second, China has a population of 1.3 billion, which means abundant and cheap labor resources, while Korea though has a dense population, lack of labor resources due to the large scale production and exportation and aging problems<sup>9</sup>. Third, Korea has relatively rich capital after years of increasing economy and reservation fund, while China is lack of fund because of the rapid economic expansion. Fourth, Korea is strong in manufacturing and technology, but weak in basic tech and aero-space technology. China enjoys the advantage of competitive research and development capacity, reaching high level of development.<sup>10</sup>

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<sup>9</sup> Gao Changchun & Fan Zhouyi & Zheng Wenwen, "The Impact of Intra-industry on Industry Competition," *Commercial Research*, 23, 2006, pp.23-25.

<sup>10</sup> Hu Junfang, "The Cause of Trade Deficit between China and Korea and the Remedies," *International Forum*, 2, 2007, pp49-52.

Table 4 – 3 Revealed comparative advantages on the resources intensive products of

China and South Korea : 2003-2007

Industry classification (SITC unidigit)	Year	China	Korea
Food and Live Animals Used Chiefly for Food (0)	2003	0.91	0.26
	2004	0.84	0.26
	2005	0.79	0.23
	2006	0.70	0.20
	2007	0.62	0.19
Beverages and Tobacco (1)	2003	0.34	0.13
	2004	0.35	0.18
	2005	0.31	0.22
	2006	0.24	0.24
	2007	0.23	0.22
Non-Edible Raw Materials(2)	2003	0.58	0.34
	2004	0.54	0.36
	2005	0.46	0.34
	2006	0.31	0.35
	2007	0.31	0.31
Mineral Fuels , Lubricants and Related Materials (3)	2003	0.35	0.54
	2004	0.31	0.58
	2005	0.32	0.49
	2006	0.32	0.45
	2007	0.16	0.54
Animal and Vegetable Oils, Fats and Wax (4)	2003	0.16	0.03
	2004	0.13	0.03
	2005	0.08	0.03
	2006	0.07	0.02
	2007	0.08	0.03



Table 4-4 : Revealed comparative advantages on the labor intensive products of

China and Korea : 2003 – 2007

Industry classification (SITC unidigit)	Year	China	Korea
Light and Textile industrial Products, Minerals Metallurgical Products (6)	2003	1.22	1.26
	2004	1.17	1.26
	2005	1.15	1.17
	2006	1.07	1.10
	2007	1.16	0.99
Miscellaneous Products (8)	2003	2.96	0.61
	2004	2.44	0.56
	2005	2.31	0.49
	2006	2.15	0.47
	2007	2.01	0.44

Table 4 – 5 :Revealed comparative advantages on the capital and technology intensive products of China and Korea: 2003—2007

Industry classification (SITC undigit)	Year	China	Korea
Chemicals and Related Products (5)	2003	0.54	0.89
	2004	0.49	0.81
	2005	0.42	0.78
	2006	0.38	0.79
	2007	0.38	0.78
Machinery and Transport Equipment	2003	0.80	1.41
	2004	0.89	1.40
	2005	0.95	1.49
	2006	1.06	1.53
	2007	1.12	1.56

Data source : the data of China is from China Statistical Yearbook (2008) ; the data of Korea is from Korea International Trade Association (<http://global.kita.net>) ; the data of the world is from the web site of UNSD—UNCom trade data base; the final results are calculated by the author.

### 4-3 Intra-industry Trade Complementarities between China and South Korea

#### 4-3-1 The Indicator of Intra-industry trade

Currently, the most widely used intra-industry trade indicator was proposed by Grubel and Lloyd (1975). Assume  $x$  and  $M$  stand for the product mix of class  $i$  or

FOB and CIF of industry export respectively, thus the intra-industry trade can be formulated as follows:

$$IIT_i = \left[ 1 - \frac{|X_i - M_i|}{X_i + M_i} \right] \times 100\%$$

When concretely measuring the intra-industry trade of the two countries, the formula above can be revised as follows:

$$IIT_j^i = \left[ 1 - \frac{|X_j^i - M_j^i|}{X_j^i + M_j^i} \right] \times 100\%$$

And  $X_j^i$  stands for the export sales to the partner country j from the industry i of one country (calculating according to the price of FOB). And  $M_j^i$  stands for the import sales of industry i of one country from its partner country j (calculating according to the price of CIF).

When the industry i is all of inter-industry trade,  $IIT_j^i$  equals to 0. When the industry i is all of intra-industry trade,  $IIT_j^i$  equals to 1. Thus, generally speaking, the intra-industry trade index  $IIT_j^i$  is a figure between 0 and 1. When close to 1, it indicates that the proportion of intra-industry trade of the country's industry i is larger, and contrarily, when closer to 0, the proportion of inter-industry trade of the country's industry I is greater.

Intra-industry trade refers to the trade communication of differentiated products of the same industrial field between two countries. According to statistics, export and import products of the same industrial field embodies that there is complementary trade demand in this industry. Higher IIT index reveals more competition and more differentiated products, with complementarities existent in intra-industry trade.

### 4-3-2 The Result and Its Interpretation

From table 4-6, we can perceive that the level of intra-industry trade in the class 1, 2, 3 and 7 is high. According to the international regulations, products of IIT index over 0.8 are rendered as the standard products in the intra-industry trade. In 2007, there were 6 classes industries are mainly intra-industry trade. (Class 1, 3, 6, 8 and 9) In addition, others can be noticed that the IIT index of products of each class of China and South Korea was on increase from 2003 to 2007, especially class 6 and 8.

Table 4–6 : Intra-industry trade of products of each class of China and South Korea:2003–2007.

Industrial classification (SITC)	2003	2004	2005	2006	2007
Food and Live Animals Used Chiefly for Food (0)	0.15	0.14	0.12	0.14	0.24
Beverage and cigarette(1)	0.99	0.89	0.98	0.83	0.95
Inedible materials(2)	0.92	0.92	0.93	0.99	0.97
Raw mineral materials, lubricant and other related products(3)	0.77	0.86	0.92	0.93	0.86
Oil and grease and wax(4)	0	0	0	—	—
chemicals(5)	0.37	0.20	0.36	0.35	0.32
Electro metallurgical Ferroalloy Products (6)	0.71	0.68	0.79	0.75	0.92
Textiles and other light industrial goods, rubber products, ore machinery, and transportation equipment (7)	0.81	0.85	0.70	0.62	0.63
Sundry goods(8)	0.64	0.59	0.30	0.64	0.91
Other unclassified products(9)	0	0	0	0.55	0.88

Data sources: annual data of International Trade Database

note : "—"stands for no trade of this class between China and South Korea

## Chapter 5

# The Strategic Plan for Establishing the FTA between China and South Korea

From the current situation, due to the difference of economic interests between China and South Korea, it will take a long time to conclude a comprehensive free trade agreement between the two countries. The current policy advises to adopt regional cooperation and construct a free trade area with the city as its center. Compared to the cooperation of state level, it is more advantageous to carry out regional cooperation, because regional cooperation cannot be confined by the systems and laws which cooperation of state level is confronted with and can help the productivity and efficiency for the key cities.<sup>11</sup> Moreover, it can be beneficial to the economic unity within regions, realizing regional economic integration with short time and less cost. Thus, regional cooperation is the most prospective operation mode at present.

According to the study and discussion of free trade agreement concluded by Northeast Asian Korea, China and Japan, it will result in the increase of GDP of these three countries, but also great unemployment in some domestic industries of disadvantages of these three countries may happen as well.<sup>12</sup> Thus it is not bright for the three countries to conclude the free trade agreement. In order to reduce the side effect brought by concluding free trade agreement to the minimum, the most proper way is to have a tryout of regional cooperation, that is to say, carry out the regional economic unity, according to the experience of other areas in the world.<sup>13</sup> It is

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<sup>11</sup> Li Lian, "Feasible analysis of FTA between China and South Korea," *Journal of Beijing Economic Management Institute*, 2, 2005, pp.21-24.

<sup>12</sup> Zhang Huizhi, "Industrial Impact of the FTA among Korea, China and Japan," *Northeast Asia Forum*, 4, 2006. pp.52-57

<sup>13</sup> Li Zhun-ye; JIN Hong-qi, "An Analysis on Trade Structure between China and Korea," *China Industrial Economy*, 167(2), 2002. pp.47-54

proved that regional economic unity has the following advantages compared to interstate cooperation:

Firstly, it makes the adjustment of interest of negotiators easy and reduces the charges negotiable. If adopting inter-governmental negotiation, it needs high charges negotiable because of the huge difference of systems. If establishing economic circle, it is unnecessary to consider the individual political aspect and the relationship of interest can be quickly adjusted in regional range.

Secondly, it can compensate the limits caused by the huge difference of both countries' economic scale and economic development phase to some extent. Since the regional economic cooperation is small-scaled, it is easy to negotiate and develop the cooperation of different departments and industries of the same level.<sup>14</sup> On the other hand, compared to the unchanging inter-state economic communication, it can meet the diversification required by economic development and market demand. Regional cooperation is of more flexibility and feasibility.

Thirdly, it can powerfully propel the regional economic exchange and cooperation. Inter-state economic cooperation can easily force weak countries to establish a unilateral system of division of labor centered by big powers and is of possibility of hegemonies. Regional cooperation is likely to establish closer relationship and form a cooperation system within regions.<sup>15</sup> Regional communication is featured with uniqueness and autonomy, which easily drives and guarantees the individual cooperation relations. Under the premise that it is difficult to establish FTA of China and South Korea in short time, Korea is now studying on the constructing regional economic cooperation network and proposes gradual

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<sup>14</sup> Zang Xin & Cui Yan, "Empirical Comparison of Japan and Korea on the Quantity, Industrial Distribution and Economic Effect of Their Investment to China," *Journal of International Trade*, 10, 2006, pp.28-31.

<sup>15</sup> Ding Yongshu, "The Effects of Non-state-run Economy on Korean Firms' Choice of Direct Investment Location in China," Master Thesis, China: Fu Dan University, 2005.

cooperation. Though unable to replace cooperation of central government, regional cooperation can be taken as one of the forms to transit into the inter-state cooperation. Regional cooperation does not exclude the participation of central government, instead it emphasizes the cooperation of local government, enterprises and residence and individuals. Meanwhile, regional cooperation admits the decisive influence of big businesses and multinational corporations as well.

### 5-1 Basic Ideas of establishing FTA

As mentioned above, regional economic cooperation should be established before FTA. As to the situation of China and South Korea, the author thinks the focus should be the Bohai and the Huanghai, which cover the areas of Korean Kyungin, Liaotung peninsula of China and Yangtze River. In those areas, there are many big cities, with perfective fundamental facility for cooperation. Among many elements of economic cooperation circle, the most important one should be the complementarities, convenient communication and advantageous location. The circle of the Bohai and the Huanghai meets all the requirements.

There are several key cities of Korea in the Huanghai circle: Incheon, Pyeongtaek, Kunsan, Mokpo, Gwangyang. Incheon is the second port city of Korea. As the peripheral city of the capital Seoul, it has developed as the habitat of automobile and heavy industry. Incheon international airport has an air line, connecting 106 cities of the world, playing a role of the aviation vital point of northeast.<sup>16</sup> It is 389 kilometers from Incheon to Shandong province of China. As the window of middle Korea open to the outside world, Incheon has an advantage of

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<sup>16</sup> Li Yingwu, "The Current Situation and the Perspective of China- South Korea Economic and Trade Cooperation," 5, 2003.pp.27-30.



China trade outpost in terms of location. Kunsan, the logistic port of middle the Huanghai , plans to set up a new port of Kunsan and free trade zone, new industries and bridgehead of Asian market logistic around the peripheral areas.<sup>17</sup>

Regional areas of China include cities of Dalian, Tianjin, Qingdao and Shanghai. Dalian as the largest city in northeastern areas shoulders all material flows of northeastern areas and is the third trade port of China. Dalian is heavy industry-oriented; however, compared to other cities of northeast, its light industry develops as well. According to data of China's National Bureau of Statistics of 2007, the proportion of heavy industry and light industry is 57: 43. Tianjin as one of the four municipalities of China and the second trade port of China is the vital pass connecting Bohai base and southeast areas of Beijing. Light industry in Tianjin is much weaker, with its focus on developing automobile, mechanic equipment, electronics, communication equipment, petroleum chemistry and fine quality steel. This city ranks first in terms of absorbing foreign investment and export scale. Qingdao is centered with bonded area, economic and technological development zone, new high-tech zone, sight-seeing area and resting area for aged people. It absorbs foreign investment and develops service industries like trade, financing and tourism, etc to strive to realize the modernization of mechanics, chemicals, food and petroleum and some traditional industries. Meanwhile, it also greatly develops overland communication networks. Qingdao is a city benefiting from China's reform and opening up policy so far now.

The Bohai circle resembles a lot with the Huanghai circle in terms of location, with convenient communication. Due to its high complementarities in economy, it is easy to change the narrow market caused by closed economy. The development of

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<sup>17</sup> Li Xiaojian & Yeung Yueman, "Transnational corporations and their impact on regional economic imbalance: Evidence from China," *Third World Planning Review*, 20, 2004, pp.86-89.

new markets brings obvious economic growth. Striving to explore domestic market demand and strengthening internal industrial cooperation can be beneficial to getting rid of excessive dependence on the developed countries when exporting finished products and importing investment, equipment and semi-finished products from other countries. When displaying the advantages of complementarities, the huge income gap of China and South Korea can be shortened.

## 5-2 Development Strategy on FTA

### 5-2-1 Differences of Special Economic Zone preferential policy

Areas open to the outside world in Korea refer to tariff free zone, free-trade area, foreign enterprises zone, foreign investment zone, international free city and economy free zone, etc. Tariff free zone includes Pusan, Gwangyang, Incheon airport, with free-trade area including Masan, Iksan, Kunsan, foreign enterprise zone including Cheonan, Pingdong. And the special economic zone that has been built or is being built is located in Linzhong, Gimpo, Songdo, Pusan and Gwangyang, etc.<sup>18</sup> The areas open to the outside world have provided foreigners with good investment environment, and preferential policies offered in terms of service industries like loading and unloading, storage, transportation, display, marketing, processing, insurance, management and salvaging, etc. Such free zone is surrounded by airports and ports, which gives full supports. In terms of ports, the capacity of dealing with annual cargo is over 10,000,000 tons, with 30,000 tons of containers for ports facilitator.<sup>19</sup> The major preferential policy lies in tariff reduction and exemption.

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<sup>18</sup> Guo Rongxing & Hwang Eui-Gak, "Cultural Diversity and Economic Development in a Panel of nations: Evidence from the Data. Korea Review of International Studies," 1, 2002, pp.67-69.

<sup>19</sup> Duan Wenbo, "Discussion on the Possibility in Construction of China-Korea FTA," Master Thesis, China; JiLing Unverisity.

With regard to incorporate tax, income tax, property tax and land tax, all benefit reduction and exemption.

Areas open to the outside world of China include economic and technological development zone, free trade area, High-tech zone, export processing zone and so on. Shenzhen, Zhuhai, Shantou and Xiamen are economic and technological development zone, free trade areas include Lian yungang, Hainan, Chinese government invest to build High-tech zone in many cities. Areas open to the outside world are designed according to tariff act, with local governments compiling and implementing the regulations respectively. It is by state department to decide the detailed regulations. And the main preferential policies is tariff reduction and exemption, providing the processing, displaying, classifying, packaging, trademark, preservation, shipping, procedures of import and export, financial service and logistics with extensive insurance as well as simplifying procedures of customs clearance.

## 5-2-2 Implement of development strategy of FTA

Considering the factors in each respect, economic cooperation of FTA is of great possibility to gradually become the strategy by stages. The content is as follows: firstly, some area of high economic communication currently and easily being formed cooperation within areas should be chosen as the key point. Then with this area as the center, it should spread to other areas and expand the cooperation by making use of its influence.<sup>20</sup> The preferred way of cooperation is to take the most thriving city as its first level, and then the second and third level cities are built through the influence of

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<sup>20</sup> Chen Zhiheng & Jin Shujing, "Conceptions and Problems Concerning the Establishment of a Sino-Japan-Korea Free Trade Zone," *Contemporary Economy In Japan*, 6, 2004, pp.76-78.

cooperation within areas. Here, Huanghai areas are divided into three levels and progressed.

The first level should choose the kernel city in the area. Such city must be chosen within the areas of FTA and places of the same kind. It can play its role of unifying in regional area to construct economic space of the same property. Thus, it is the most effective way to establish such city of properties of FTA.

Following such idea, the key city of the first level can be chosen as Incheon of Korea, Qingdao and areas of Tianjin of China, which are of high production capacity of manufacturing even around the whole world. They are not only the center of industry and logistics of related places but also the places where the communication of people and culture happens frequently.<sup>21</sup> These cities has their own open-up areas or conditions of such kind, thus they are of more advantageous conditions in terms of economic space of the same construction properties.

The second level is the peripheral areas influenced and driven by the first level cooperation strengthening, with its important cities Gwangyang of Korea, Dalian and Yantai of China.

The third level refers to the influence circle formed because of the cooperation effect of the first level and the second level, which indicates its phased progress.<sup>22</sup> As to this level, Pyeongtaek, Mokpo, Kunsan of Korea and Qinghuangtao of China are chosen.

### 5-3 Special Policies for the Development Strategy

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<sup>21</sup> Jiang Xianjiu, "The Feasibility and Economic Effects of the Establishment of FTA between China and Korea," Northern Economy and Trade, 2, 2008, pp.65-67.

<sup>22</sup> Wang Tao & Meng Xiaoyan, "Feasibility and Obstacle Analysis of the Sino-South Korean free Trade Area," Journal of Harbin University of Commerce (Social Science Edition), 2, 2007, pp.48-51.

In order to successfully realize the cooperation plan mentioned above, some considerations should be taken in terms of policy implementation as follows:

(1) As the theory of industry inner trade suggests, the economy of scale and product differentiation are placed in an important position. When trading with Korea, we should actively foster economy of scale. To both industries and manufacturers, economy of scale means the progress of technology and improvement of productivity. The existing industrial organization structure of our country is featured with low level of specialization and cooperation and other problems, which inevitably results in reducing our country's capacity of gaining efficiency of economy of scale from the a large wholesale of products and keeping the cost of products up.<sup>23</sup> What's more, it will also confine the development of production technology and technology, greatly weakening the competitiveness of our industries in the international market. And most of their products are sold to domestic market. Nevertheless, Korea is quite different from China. Compared to enterprises of China, corporations of Korea is much larger in scale. Many enterprises like Samsung, LG and DAEWOO are rich in experience in scale operation.<sup>24</sup>

Enterprises of China if wanting to better develop horizontal industries must upgrade the scale of domestic industries on the foundation of strengthening the division of labor based on specialization and form sustainable completion force. When focusing on developing big businesses, we should perceive that there are many small and medium-sized enterprises in our country. However, the coordination between big businesses and small and medium-sized enterprises is relatively losing, with low level of industrial specialization, which makes the efficiency of scale

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<sup>23</sup> Li Junjiang & Fan Shuo, "A Conception of the Establishment of Sino-Korean Free Trade Zone," Journal of Jishou University(Social Sciences Edition), 2, 2006, pp.31-33.

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economy insufficiently obvious. "Specialization and cooperation is the objective requirements of socialization of production and the development of market economy and the basic condition of changing in the main source of economic growth and improving quality and efficiency of economic growth."

Coordination between enterprises of our country is low from the aspect of overall level, which is mainly reflected as follows: plenty of all-round enterprises featured with "big and competent" "small and competent" exist. And the coordination between big businesses and small and medium-sized enterprises is insufficient, especially the production of inner industries, technological contact. It results in small and medium-sized enterprises unable to have complementary advantages with each other, which improves the production cost and unnecessary expenditure. It also makes small and medium-sized enterprises compete to occupy the raw materials and market, which brings serious waste of resources. Due to the drop of productivity and qualified rate of product as well as the loss of renovation, the efficiency of division of the work is lost, which finally weakening the whole competitiveness of the industry. Not fully making use of the external advantages of economic scale of our enterprises, the productivity and economic efficiency is weakened, making the enterprises in a disadvantageous position when participating in the intra-industry trade.

Under the guidance of economy of scale theory, we should first foster a group of large-scale multinational companies of competitiveness to improve the spatial efficiency of source distribution. On the other hand, the structure of scale of enterprises should be optimized and the degree of industrial concentration needs upgrading. Division of work and cooperation within enterprises need reinforcing. Market mechanism should be fully exerted in the industrial structure adjustment. ;The

industrial scale economy criteria and policies for guiding regional industries should be carried out. Cooperation and coordination within industries should be encouraged so as to establish the modern industrial organization structure centered by big businesses. Small and medium-sized enterprises are not encouraged to merely pursue the expansion of the scale; instead, they should adjust the operation strategy based on the progress of technology and according to the specialization division principles. They should strengthen the contact with big businesses to constantly the competition of our country's enterprises with intra-industry trade j and let our country's enterprises play its own role in trading with Korea.

(2) Intra-industry trade mainly centered with differential products, whose content is very extensive, including the differences of profile, quality, style, color and trademark, etc. China tends to overlook the effect of product differences in international trade, which results in low product differentiation in China.

For many years, traditional products exported to Korea from China mainly belong to products of resource intensive and labor intensive.<sup>25</sup> Currently, these products face the fiercest competition in the international market and easily subject to shock. In recent years, though the commodity structure to Korea from our country has been modified, it is still of the obvious characteristics of labor intensive and resource intensive with low added value and low technology, such as aquatic product, cotton, vegetables and fruits and textile garments, etc. These products earn low profits and little foreign exchange, making the trade development of the two countries imbalance. Thus, we should expand the trade range on the basis of keeping preserving relatively advantageous traditional products export so as to realize the diversification of export

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<sup>25</sup> Lan Li, "Feasible analysis of FTA between China and South Korea," Journal of Beijing Economic Management Institute, 2, 2005, pp.76-79

commodities. In order to further improve the quality of export products, especially the export share of new and high-tech products, we should pay more attention to the brand strategies and foster the consciousness of brand in our country, which is the important link of strengthening intra-industry trade with Korea.

Meanwhile, it is of importance to greatly develop technology trade between two countries. Currently, China has the first-rate technology and products of basic scientific fields in the world, such as aviation, biochemistry, nanotechnology, breed improvement, automobile spare parts, photo-electronic, broadband IP, network video, SPC exchange, etc ,which is more advanced than those of Korea. On the contrary, there is a lot for China to learn from Korea in respects of CDMA mobile phones, chip, automobile manufacturing and shipbuilding, etc. From the data mentioned above, it is easy to notice that China is a country of high technology. Therefore, when developing intra-industry trade between China and South Korea, we should change the trade direction into these products, which are characterized with high added value and high technology. With relatively high capital and technology intensiveness, these key industries can carry out technology and production renovation. Moreover, they are of higher economic growth rate and labor growth rate than other industries. Striving to develop intra-industry trade can propel the intra-industry rate between China and South Korea from elementary stage to senior stage and promote the rapid development of intra-industry between two countries.

(3) For a developing country lacking of capital elements, the international investment is evitable for its economic development. However, when absorbing the international investment from Korea, we should realize that the real purpose of the investment of Korea enterprises in China is not for the optimization and final



development of China industries. In order to maintain their monopoly dominant position especially the advantages of the technology, these Korea multinational corporations try to preventing their technology flowing into our country so as to achieve their global operation strategy. Most enterprises of Korea covet cheap labor and resources in China and let some minor departments of small added value built in our country. Therefore, what enterprises of our country have got is only a little processing charge. We should be clear-minded to the investment of Korean enterprises instead of merely pursuing the increase of trade volume. What's more, processing trade which plays a great role in upgrading of industrial structure should be taken into consideration as well.

When developing processing trade, China can step into the international industrial linkages of Korean multinational corporations in processing cooperation with Korea. Firstly, China involves into the labor intensive processing link (for instance, assembly, fixation) and then steps into the capital intensive processing link (for instance the production of components and intermediate goods). Finally, it enters the capital and technology intensive link (like OEM and production of own-brand product) so as to fulfill the rapid upgrading of industrial structure. In addition to, when absorbing the investment of Korean enterprises, we should adapt to the current adjustment of industrial structure, with area preferential policy replacing industrial preferential policy. With the help of credit and loan, revenue and some preferential policies, the Korean investment are led to flow to the new and high-tech industries like semiconductor, communication equipment, etc as well as the infrastructure construction fields like agro-products processing, equipment replacement of traditional industries and energy and transportation and so on. Consequently, trade of

large-sized electromechanical equipment and technology of both countries are driven to develop.

(4) Trade between China and South Korea has been in the phase of rapid development. In order to avoid trade dispute intensifying, when governments of the two countries reinforce coordination function of relative departments, coordination scope should be expanded through institutions like China and South Korea Trade Unions so as to help the official or semi-official organizations fully work, propelling balanced development of economic trade of both sides. Besides, Korea should further open its domestic market to China and abolish the policy of limits of parts of goods imported from China and the tariff rate to implement counter trade.<sup>26</sup> China should pay more attention to adjusting its export commodity structure to Korea and develop the export processing industries to meet the export needs of the other side. The transformation speed of high added value export commodity production should be quickened. Meanwhile, the return selling channel for the export commodities to Korea should be used to expand the variety and quantity of export commodities of Korea.

China is a developing country with a large population and broad domestic market. During the development of foreign economic relations and trade, though it is impossible that the trade can be balanced with all countries in all fields in short term, the trade deficit of Korea has been constantly expanding, which inevitably can promote the healthy development of economic and trade relations between the two sides. In fact, it is possible for the two countries to realize the balanced development in trade, for more than 70% are manufactured goods in their trade, which indicates the strong complementariness for both sides. As long as both sides pay more attention to

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<sup>26</sup> Jin Ruixuan, "Study on the Driving Strategy of FTA between China and Korea," Master Thesis, China: JiLin University, 2006.

the import from the other side when actively expanding exports, the two countries can achieve the balanced development in the near future.

(5) It is an undeniable truth that China and South Korea are complementary in their cooperative trade and that there exist competitions of different degrees in some commercial field. Thus, the two countries should make greater efforts to discard unhealthy ideas in competition with each other and carry out constructive policies so as to avoid the extreme views and actions harmful for both sides. As to the "China Economic Threat" "Agricultural products of China shock the Korea domestic agricultural product market" (mainly refers to garlic, chilies and sesame oil, etc) and "damaging the interest of farmers" which once prevailed in Korea, the Korea has carried out the policy of anti-dumping measures against China. The conflict was finally settled after many rounds of negotiations between the two sides. However, public opinion related in Korea does not disappear completely. Sometimes, trade friction with Korea happens as well. From now on, public opinion mentioned above may return again, with trade dispute intensifying. Therefore, China should strengthen the further research plan of trade cooperation with Korea and adopt practical trade policies and measures, making the trade between China and South Korea grow successfully and in a sustainable manner.

As a matter of fact, it is not avoidable for the two sides to compete on commodities markets, for competition is the basic principle of market economy. It is against nature to avoid competition in the environment of market economy. Moreover, the fierce competition between the two countries in the market has been the force for the development of their commodities. However, the competition in some field is unlikely to bring threat to economic development of Korea. Based on the overall and

long-term interest, it is of necessity to transfer precaution into cooperation and coordination and jointly produce famous-brand products of high quality by fully making use of its own advantages.

In terms of agricultural products, both sides have complementary advantages. China can take the advantage of the large number of some agricultural products, with Korea taking the advantage of its national flavor and technique. That is to say, Korea imports some China agricultural products and China imports some of the manufactured agricultural products, such as pickles, seasoning, jam and marine products. It is also advisable that some enterprises from Korea are welcomed to invest in China to establish the production bases of agricultural products. Moreover, by using the raw materials of China, semi-finished products or finished products are produced to export to Korea and other countries for common interest.

(6) Currently, the information communication channel between China and South Korea remains quite limited. Though the information China introduces from Korea has been increased comparatively, it still lacks of practical information helpful for developing trade with Korea. Meanwhile, Korea introduces relatively more information from China, however, the accuracy and comprehensiveness need to be improved to avoid misunderstandings. In light of this, both sides should further expand communication with each other, providing enterprises with much more comprehensive and systemic consulting service and helping each other understand each other better. In addition, related departments of both sides should organize their investors to intern in the companies of the other side to helps them know more about their partners' operation and management mode as well as staff relation and corporation culture. This is to improve localization of the enterprises and promote

bilateral economic cooperation. It is conducive to the healthy development of trade to strengthen communication between research institutions and scholars of the two sides. It is of great propellant to carry out the academic communication between research institutions and scholars of China and South Korea. By academic communication, a further discussion about the problems of trade development between both sides is carried out and some relevant solutions and measures are turned out as well, which is conducive to driving China and South Korea trade to develop successfully. It is believed of great help for the economic trade between the two sides as the communication further progresses.

## Chapter 6

### Conclusion

After China and South Korea established diplomatic relations, the scale of trade between the two countries increases rapidly, with the soaring of china's trade deficit to Korea. The huge deficit results from the facts such as different stages in economic development with corresponding trade policy, China's FDI from Korea, the different trade comparative advantage, the problems in statistics, and so on. To reduce this deficit, China must encourage technological innovation, accelerate the dynamic transformation of trade comparative advantage, improve trade structure, set up reasonable trade development strategy and policy and strengthen mutual institutional cooperation.

There are several limitations of this study need to be discussed. South Korea's imports of some products on the set all kinds of trade barriers; the impact of China has a comparative advantage in export products. This is also the important reason of trade deficit widened between China and South Korea. How to make mutual profit is a topic worthy of in-depth study.

China itself has a lot of problems. Product quality and grades needs to be raised. China's exports to South Korea for more resource-intensive and labor-intensive products, but such products are most competitive and vulnerable currently on the international market. Therefore rising tendency of high-tech products export of China will continue to strive to.

Now is the best time to discuss and establish China and South Korea FTA. After painstaking efforts just out of its predicament which caused by the severely strike of the financial crisis in Asia, Korea eager to expand economic cooperation with foreign

countries. South Korea reached free trade agreement with Chile, Singapore and other countries that reflect the desire of South Korean which need to strengthen economic cooperation. As for China it is in the critical moment of reform and development, and also wants to build and strengthen economic cooperation with foreign countries.

Recently China and South Korea are at a critical period of economic development and turning points, both of them need to strengthen economic and technological cooperation. According to this, we have to seize this opportunity to establishing the free trade agreement between two countries for raising the level of bilateral economic and trade development. This 'win-win' structure is appealing to each country.

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